No. 80-202

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

AMERICAN EXPRESS COMPANY,
Petitioner,

v.

LOUIS R. KOERNER, SR.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

I. THE BUSINESS PURPOSE EXEMPTION IS NOT LIMITED, AS RESPONDENT CONTENDS, TO CREDIT ACCOUNTS THAT ARE CONTRACTUALLY RESTRICTED TO BUSINESS USE.

Respondent argues that individuals who are jointly liable for debts incurred on a company credit card account should be treated as "consumers" whenever there is *any* personal use of the account whatsoever. Resp. Br. at 7, 20-24. He therefore concludes that the business purpose exemption contained in § 104(1) of the Act is inapplicable in this case. He further contends that the business purpose exemption should be available only for those accounts—unlike the Koerner company account—that contain a contractual restriction limiting their use exclusively to business purposes. *Id.* at 8, 24. The language of the statute, the legislative history, prior court

decisions, and the rulings of the Federal Reserve Board offer no support for any of these arguments.[1]

The language of the Act is dispositive. The term "consumer," as defined in § 103(h) of the Act, refers only to those transactions in which

> the party to whom credit is offered or extended is a natural person, and the money, property, or services which are the subject of the transaction are *primarily* for personal, family, household, or agricultural purposes.

15 U.S.C. § 1602(h) (1976) (emphasis added).[2] The use of the word "primarily" in the definition anticipates that credit will often be extended for mixed purposes and requires that such mixed transactions be classified according to their predominant purpose. Only if the transaction has a predominantly consumer purpose can it be treated as a consumer credit transaction covered by the Act.

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[1] To the extent that Respondent is arguing that all individuals jointly liable for credit card debts are "consumers" protected by Truth-in-Lending, he has totally ignored the showing in our main brief (Pet. Br. at 8-18) that Congress intended the business purpose exemption to extend to all types of obligors—individuals and proprietorships as well as partnerships and corporations—as long as the credit was being obtained for business or commercial purposes.

Nor can the Fifth Circuit's decision be saved by trying to limit the holding, as Respondent suggests (Resp. Br. at 2), to the Fair Credit Billing Act. The Fifth Circuit itself purported *not* to be interpreting § 161, 15 U.S.C. § 1666 (1976), and the explicit language of that section indicates clearly that it was designed to cover only open end consumer credit plans and was thus intended to be subject to the business credit exemption. *See* Pet. Br. at 19.

[2] Likewise, Regulation Z defines consumer credit to mean

> credit offered or extended to a natural person, in which the money, property or service which is the subject of the transaction is *primarily* for personal, family, household or agricultural purposes.

12 C.F.R. § 226.2(p) (1980) (emphasis added). *See also* 46 Fed. Reg. 20848, 20893 (April 7, 1981) (new Regulation Z definition of "consumer credit" contained in revised § 226.2(a)(12)).

Section 104(1), 15 U.S.C. § 1603(1) (1976), the business purpose exemption, reflects the other side of the coin. Although the word "primarily" appears only in § 103(h), the courts have uniformly read a similar concept into the "business purpose" language of § 104(1). *See Redhouse* v. *Quality Ford Sales, Inc.*, 511 F.2d 230, 235 (10th Cir. 1975); *Brill* v. *Newport National Bank*, Consumer Credit Guide (CCH) ¶ 99,057 (S.D.N.Y. 1973); *Smith* v. *Chapman*, 436 F. Supp. 58, 61 (W.D. Tex. 1977), *aff'd*, 614 F.2d 968 (5th Cir. 1980).[3] As Senator Proxmire stated in congressional debate prior to passage of the original Act, the bill "would not cover . . . credit extended *primarily* for business or commercial purposes." 113 Cong. Rec. 18401 (1967) (emphasis added).

Respondent tries to avoid the clear statutory language against his position by arguing that a "primary purpose" test cannot sensibly be applied to credit cards that are usable for multiple purposes. Besides having no basis in the language or legislative history of the Act, this argument misses the point. Section 104(1) exempts

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[3] *Redhouse* v. *Quality Ford Sales, Inc.*, 511 F.2d 230 (10th Cir. 1975), concerned a credit transaction involving the purchase of a pickup truck for mixed personal and business purposes. The court held that the business and personal uses of the truck must be weighed to determine which use was predominant. The court stated that such a credit transaction would be exempt from the Act "whenever the vehicle usage is 'predominantly' commercial and it need not be 'entirely' commercial." *Id.* at 235.

In *Brill* v. *Newport National Bank*, Consumer Credit Guide (CCH) ¶ 99,057 (S.D.N.Y. 1973), plaintiffs had purchased an apartment building in Newport, Rhode Island, consisting of five units, and had mortgaged the property to the defendant. Plaintiffs used one unit as a summer vacation home but rented it out during the remainder of the year. Three units were held out for rent year round, while the remaining unit was available to a single individual in return for caretaker services. Comparing the number of units available for rent with those reserved for plaintiffs' own personal use, the court held that the building was primarily a business venture and that the financing was therefore exempt from the Truth-in-Lending Act. *Id.* at 88,858.

"*transactions involving* extensions of credit for business or commercial purposes." (Emphasis added.) This language presupposes that one transaction can involve multiple extensions of credit, and it requires that the exemption be applied to the transaction as a whole, not to the underlying extensions of credit. Indeed, the section of the Act that American Express supposedly violated in this case—§ 161(d), 15 U.S.C. § 1666(d) (1976)—covers only an "open end consumer credit plan" which, by its nature, involves multiple extensions of credit under a single plan.

For such plans, the "transaction" exempted by § 104(1) is the plan as a whole, and the purpose of the transaction must be determined by looking to the purpose of the parties in entering into the transaction. Since the Koerner company, Mr. Koerner personally, and American Express all agreed to the opening of a "company account" (J.A. at 27a-28a),[4] the District Court was justified in holding that the parties had entered into a credit transaction that was primarily for business or commercial purposes and was thus exempted by § 104(1). Whether or not the Koerner company chose to permit Mr. Koerner to use the company card to make some personal purchases, that action cannot override the initial agreement of all the parties that they were engaging in a business transaction.

As our main brief makes clear, this reading of the statute is both compelled by its language and sensible in practice. Card issuers must determine, for each account, whether or not compliance with the complicated procedures mandated by Truth-in-Lending is required. Section 127(a), 15 U.S.C. § 1637(a) (1976), requires making initial disclosures for non-exempted accounts; § 127(b), 15 U.S.C. § 1637(b) (1976), requires sending periodic statements; and § 161, 15 U.S.C. 1666 (1976), establishes

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[4] Respondent has conceded that all of the billing to the Koerner Company was done "as a business account." J.A. at 25a, 30a.

detailed procedures for resolving billing error inquiries. Each set of requirements must apply to an entire account or must be entirely inapplicable. A rule requiring different results for each charge ticket, depending on the precise facts relating to the cardholder's motivation for using his card to charge the merchandise in question, would make no sense at all. Since Congress made it clear that the business purpose exemption was to be applicable to the billing error provisions added to the Act in 1974, and since these provisions apply to credit card accounts (*see* Pet. Br. at 20), Congress must have intended that establishment of a business credit card account could be a "transaction involving extensions of credit" exempted by § 104(1).[5]

Respondent cannot avoid the effect of the exemption by arguing that it should not apply because he was jointly liable, as an individual, on the business account. Respondent's lengthy recitations of Louisiana law on this point are totally irrelevant. *See* Resp. Br. at 10-17. As we have shown in our main brief, the crucial question under the Act is not *who* is liable but what the *purpose* of the transaction is. *See* Pet. Br. at 8-18. Here, Respondent was not opening a personal card account for his personal use, as he was perfectly free to do (assuming that he qualified for a personal card). He was asking, in conjunction with the Koerner company, that a company card obtained for a business purpose be issued to him. That was an exempted transaction under § 104(1) whether Respondent was liable as a surety, as a co-obligor, or even as a sole obligor.[6]

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[5] As defined in the Act, credit includes not only the right to defer payment on a particular debt, but also the right to incur debts and defer payment of them. § 103(e), 15 U.S.C. § 1602(e) (1976); 12 C.F.R. § 226.2(q) (1980). Therefore, a credit card account—representing the "right to incur debt and defer its payment"—constitutes "credit" for purposes of the Truth-in-Lending Act, and the opening of the account involves a credit transaction. § 226.2(u) (1980), makes it entirely irrelevant whether Respondent was a surety or a co-obligor. Under the explicit language con-

[6] An existing provision of the old Regulation Z, 12 C.F.R.

II. THE FEDERAL RESERVE BOARD HAS UNAMBIGUOUSLY REJECTED RESPONDENT'S POSITION.

Respondent's arguments relating to the Federal Reserve Board's administrative construction of the Act (Resp. Br. at 24-33) are both confusing and confused. In addition, a recent development—the Board's issuance of an entirely revised Regulation Z on March 26, 1981—renders most of Respondent's contentions irrelevant. A few words are therefore necessary to set the record straight.

In Public Information Letter No. 727, issued in late 1973 (Pet. App. at 3g), the Federal Reserve Board staff analyzed the applicability of the Truth-in-Lending Act in a situation identical to the one involved here. A corporation and a corporate employee were jointly and severally liable for obligations incurred on the employee's company credit card. In answer to a question relating to the applicability of the business credit exemption to such a card system, the staff stated that

> [i]f the credit is for business or commercial purposes, it would not be subject to Truth in Lending by virtue of the exemption in § 226.3(a).

Respondent attempts to distinguish this holding by noting that this letter dealt specifically with the disclosure sections of the Act, not the billing error provisions. But this distinction has force only if the business credit exemption applies only to the disclosure provisions, and not to the billing error provisions. The Board has rejected that contention. Public Information Letter No. 1004, issued in 1976 (Pet. App. at 7g), holds specifically that the business purpose exemption does apply to Fair

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tained in the definition of "customer," a term that triggers the substantive sections of the Regulation, comakers, endorsers, guarantors, and sureties are either equally covered—or equally not covered—by the Regulation.

Credit Billing.[7] Accordingly, the rulings in letters 727 and 1004, taken together, are dispositive.

Respondent suggests, however, that Public Information Letter No. 727 provides support for his contention that the business purpose exemption will not apply where a credit card is used for both business and consumer purposes. Respondent is mistaken. The letter in fact states:

> [I]f the purpose of the credit is mixed but *primarily* for personal, family, household or agricultural purposes, the credit would be subject to Truth in Lending's provisions. *However, we suspect that few cards, if any, which are issued with a corporation as a cardholder would fall within this category.*

Pet. App. at 3g-4g (emphasis added). This ruling adopts a "primary purpose" test for credit cards fully consistent with the holding of the District Court in this case.[8] We submit that the Fifth Circuit erred in overturning that decision.

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[7] Respondent attempts to minimize the significance of Public Information Letter No. 1004 by arguing that the facts stated in that letter are not identical to the facts of this case. But the card system involved there does not appear to be any different from the card system involved here. Although Letter No. 1004 does not specifically state that individual employees were jointly liable under the system involved there, it does not say that they were not liable either; the fact that bills were sent only to the company is not dispositive of the liability point since Respondent Koerner did not receive bills either. J.A. at 25a, 30a. The letter is simply silent on the liability issue. The critical point, however, is that the letter does find the business purpose exemption applicable to the Fair Credit Billing provisions. This is the one issue in this case not addressed by Public Information Letter No. 727.

[8] Respondent relies on Public Information Letter No. 821 to argue that where credit extended to a natural person may be for both consumer and business purposes, the business purpose exemption will not apply. But that letter does not support Respondent. The letter indicates only that where there is uncertainty as to the purpose for which credit was obtained, the creditor may find it *prudent* to comply with Truth-in-Lending requirements. The letter does not rule as a matter of law that the business purpose exemption cannot apply where mixed purposes may be involved.

Finally, it should be noted that the Federal Reserve Board has recently reaffirmed the position it took in the letters discussed above when it issued a completely revised Regulation Z, which took effect on April 1, 1981.[9] 46 Fed. Reg. 20848 (April 7, 1981). The revised Regulation rewrites the language creating the business purpose exemption:

> This regulation does not apply to the following:
>
> (a) *Business, commercial, agricultural, or organizational credit.** (1) An extension of credit primarily for a business, commercial or agricultural purpose.
>
> (2) An extension of credit to other than a natural person, including credit to government agencies or instrumentalities.

* Extensions of credit that are exempt under paragraph (a) (1) and (2) remain subject to § 226.12(a) and (b) governing the issuance of credit cards and the liability for their unauthorized use.

§ 226.3, 46 Fed. Reg. 20894 (April 7, 1981). Under this unambiguous language, the business purpose exemption will apply whenever credit is extended *primarily* for business or commercial purposes. Respondent's argument that an exclusive business purpose is required has thus been flatly rejected. The new Regulation also states that the exemption applies to all provisions of the Regulation other than those which are specifically excepted. Because the Fair Credit Billing provisions are not among the excepted sections, they are fully subject to the exemption.

The new formulation of the Fair Credit Billing provisions in the revised Regulation Z takes the same approach. These provisions have been rewritten so that

[9] Creditors have the option of complying with the old Regulation Z until March 31, 1982. Beginning April 1, 1982, creditors subject to Regulation Z must comply with the revised Regulation. 46 Fed. Reg. 20848 (April 7, 1981).

they apply only to "consumers." § 226.13, 46 Fed. Reg. 20899 (April 7, 1981). A "consumer" is defined to mean "a cardholder or a natural person to whom consumer credit is offered or extended." § 226.2(a)(11), 46 Fed. Reg. 20893 (April 7, 1981). A "cardholder" is in turn defined to mean

> a natural person to whom a credit card is issued for consumer credit purposes, or a natural person who has agreed with the card issuer to pay consumer credit obligations arising from the issuance of a credit card to another natural person. For purposes of § 226.12(a) and (b), the term includes any person to whom a credit card is issued for any purpose, including business, commercial, or agricultural use, or a person who has agreed with the card issuer to pay obligations arising from the issuance of such credit card to another person.

§ 226.2(a)(8), 46 Fed. Reg. 20893 (April 7, 1981). Because the Fair Credit Billing provisions are not among the excepted provisions, only natural persons who are liable for credit cards issued for *consumer credit* purposes, defined to mean "credit offered or extended to a consumer primarily for personal, family or household purposes," § 226.2(a)(12), 46 Fed. Reg. 20893 (April 7, 1981), can gain their benefit. As the Board's commentary states, "cards issued for non-consumer credit purposes are covered only by the provisions regarding credit card issuance and liability." [10] This result is identical to that reflected in Letters 727 and 1004.

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[10] The Board states in its interpretation of the revised regulation that the definition of "cardholder" involves no change in meaning from the old regulation. The relevant paragraph states in its entirety:

> This definition differs in structure, but not in scope, from § 226.2(m) of the current regulation. The current regulation provides that a "cardholder" means any person to whom a credit card is issued for any purpose. Because of limitations set forth elsewhere in the act and regulation, however, general coverage is in fact restricted to natural persons who are issued

The rulings of the Federal Reserve Board Staff contained in the interpretive letters, and sustained in revised Regulation Z, are not demonstrably irrational. Under the rule of *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980), discussed in Petitioner's brief at 14-15, these rulings are dispositive.

CONCLUSION

For the reasons set forth above and in Petitioner's main brief, the judgment of the Court of Appeals should be reversed, and the judgment of the District Court reinstated.

Respectfully submitted,

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the cards for consumer credit purposes. Other persons to whom cards are issued and cards issued for non-consumer credit purposes are covered only by the provisions regarding credit card issuance and liability. The revised definition reflects this distinction, as did the December proposal, and makes clear that a natural person guaranteeing a business credit card is not a cardholder except for the limited purposes of § 226.12(a) and (b).

46 Fed. Reg. 20850 (April 7, 1981).